TALKING POINTS

for NSC 25 March 1982

1. The USSR's Hard Currency Problem
2. Soviet Savings Through Subsidized Credits
3. Recent Soviet Pipeline Developments
4. East European Financial Situation
5. Poland's Prospects for the Next 12 to 18 Months (SNIE 12.6-82)

Approved For Release 2007/07/25 : CIA-RDP84B00049R000200420003-6

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The USSR could not cut imports easily because the volume of imports other than food has already stagnated, while import requirements are continuing to rise.

Gold sales could be stepped up, but prices are already falling and the USSR runs the risk of spoiling the market even more.

-Even if the USSR managed to cut nonfood imports by 10 percent in volume terms and sold all its net domestic production of gold it would still face a substantial financial shortfall.

-Ultimately the USSR might well have to look to foreign credits as a short-term solution to its payments problem.

In light of recent Soviet practices and a growing wariness on the part of the financial community over Soviet creditworthiness, borrowing will be costly.

Moscow has not been in the commercial market place for substantial mid or long term loans since 1979.

A decision to reenter that market now could have a negative impact to the extent it fuels speculation that Moscow is borrowing to pay off Polish debts.

Soviet debt in fact already increased sharply in 1981.

--Short term borrowing, however, would close the financial gap for only a year or two. Beyond this, the longer term outlook for the USSR's payments position is not rosy.

-The volume of Soviet hard currency exports is likely to stagnate during the coming decade.

The volume of Soviet crude oil exports has been falling. With domestic oil production leveling off or in decline, the USSR will find it extremely difficult to prevent a further drop in oil exports for hard currency.

Gas exports will continue to increase--but not on a large scale until the export pipeline can be completed--late in the decade.

Arms exports for hard currency appear to have leveled off for lack of large new clients.

- Moscow's main hope for sizable increases in hard currency earnings would be another large jump in the prices of oil, gas and gold--in the case of oil, an event that appears unlikely in the next two or three years, but increasingly likely during the second half of the 1980s.

- If Soviet hard currency earnings level off or decline, Moscow will need to increase its new borrowing from the West--and its debt--to avoid a fall in hard currency imports.

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Talking Points

Recent Soviet Pipeline Developments

Both the Soviets and West Europeans are proceeding with the export gas pipeline project.

-- The most important recent development affecting the viability of the export pipeline project was the reported decision by Ruhrgas to attempt to reduce Soviet gas exports by 20 percent from the 10.5 billion cubic meters agreed to in last November's contract. Ruhrgas allegedly had overestimated West German gas demand. [redacted] for example, [redacted] price of 5.40 mm BTU's. Given the present softness of all energy markets, Ruhrgas may well seek to cut the quantity purchased or the price--or both--if the Soviets are amenable. The Soviets, however, will oppose any alteration of the contract that will adversely affect project economics or reduce net hard currency earnings from gas exports. 25X1

-- Meanwhile, the USSR has continued to focus on circumvention or US sanctions and on obtaining reassurances that West European contractors and subcontractors intend to fulfill their contracts.

- Moscow reportedly has broached the subject of getting technical help from Western turbine firms to manufacture a Soviet 25-MW model (which may be a copy of type ordered for the export pipeline).

- Some West European firms are in weak financial condition and feel vulnerable to possible penalties for failure to deliver equipment on schedule under existing contracts.

- Generally, the West Europeans indicate that all equipment affected by the US embargo will be made and delivered eventually, with or without U.S. components

-- Soviet ability to expand existing domestic pipeline networks and to use smaller but domestically produced turbines on any additional lines points to the start of gas deliveries to West Germany, France and Italy (if it signs the contract) in 1984 as planned.

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TALKING POINTS

East European Financial Situation

--The financial crisis in Eastern Europe is spreading as most of the countries in the area are finding it hard to obtain credits.

- No East European borrower can at present obtain a syndicated Eurocurrency loan.

- Bankers are refusing to roll over some credits as they come due.

- Even the export credit agencies of some Western governments are not willing to increase their lending.

- If credit cutbacks accelerate, Hungary and the GDR, in addition to Poland and Romania, could also face rescheduling by the end of the year.

- Lack of credits will result in sharp import cuts by the East European regimes, which will slow domestic growth and lead to political instability.

- Some regimes may reluctantly turn to the USSR for help, but Moscow will be able to offer little due to its own serious problems.

- Bulgaria and Czechoslovakia do not face serious financial problems this year.

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Effect of Polish Crisis on the East European Economies

Despite their satisfaction with martial law, the East Europeans have been adversely affected by Poland's crisis:

--They have been increasingly shut out of Western credit markets. Such denial jeopardizes, in particular, the ability of Romania, Hungary, and East Germany to continue meeting their financial obligations.

--Poland's failure to deliver contracted goods has forced the East Europeans to pay at least $500 million in scarce hard currency for replacements.

--The East Europeans, already strapped by their own economic problems and slow growth, have extended roughly $1 billion in various types of largely "soft" assistance since September 1980 (about one-fourth since martial law).

--The East Germans have been forced to accelerate their lignite mining to reduce their dependence on Polish coal.

--The Czechoslovaks have allegedly talked about curtailing their exports of capital investment because of reduced Polish deliveries.

USSR: Estimated 1981 Hard Currency Transactions

(Values in billion US $)

RECEIPTS		EXPENDITURES	
Merchandise	24.0	Merchandise	30.0
Fuel	15.0	Agricultural	12.5
Non-fuel	9.0	Non-agricultural	17.5
Arms	5.0	Credits	3.5
Misc.	1.0	Debt service	5.0
Financing	6.5		
	38.5		38.5

Soviet Oil Sales to Eastern Europe

increased from 50% to 65% of market price

--The current (1982) price of Soviet crude oil to Eastern Europe is estimated at $22 per barrel (according to the 5 year moving average), or about 65 percent of the current world market price. [illegible]

--In 1981, the price was about half of the world market price (according to the formula). With crude oil deliveries amounting to 73 million tons to Eastern Europe, the East Europeans saved roughly $10 billion dollars by buying subsidized Soviet crude. (The Romanians received no benefits as they pay world market prices and in hard currency for the 2.5 million tons they received.)

--The known cuts for 1982 are

GDR: - a reduction of 2 million tons down to 17 million tons (from planned deliveries of 19 million tons).

Czechoslovak-a reduction of almost 2 million tons down to 16.8 (from planned deliveries of 18.8 million tons).

Hungary -a reduction of from one-half million tons to possibly 1.5 million tons down to 6-7 million tons (from planned deliveries of 7.5 million tons).

We know of no cuts scheduled for either Poland or Bulgaria. The Romanians may receive less, but they pay at world prices anyway.

--So far the impact has been mainly in public transportation (reduced routes, fewer runs) and private travel (higher prices).

--The cuts will definitely hurt economic growth in these three countries. Economic growth is already stagnant in Hungary and Czechoslovakia.

KNOWN Actions by West European export credit agencies to limit exposure to Soviet bloc.

Italy has halted all lending to Poland and Romania; no new official credits have been pledged to Bulgaria, Hungary, Czechoslovakia, and East Germany in past year, but they have been able to draw on existing lines: only small government-backed supplier credits have been given to the USSR recently, and Rome has yet to approve formally government-backed financing for the Siberian pipeline.

West Germany's government review committee is not accepting credit applications for deals involving Poland and Romania and has slowed the pace of approvals for the USSR, holding in abeyance applications for Soviet projects in excess of $50 million since December; other countries not affected.

France has practically halted official cover for export credits to Poland and Romania, but continues business-as-usual with other countries.

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